

# **DATA UPDATE 7 FOR 2026: DEBT AND TAXES!**

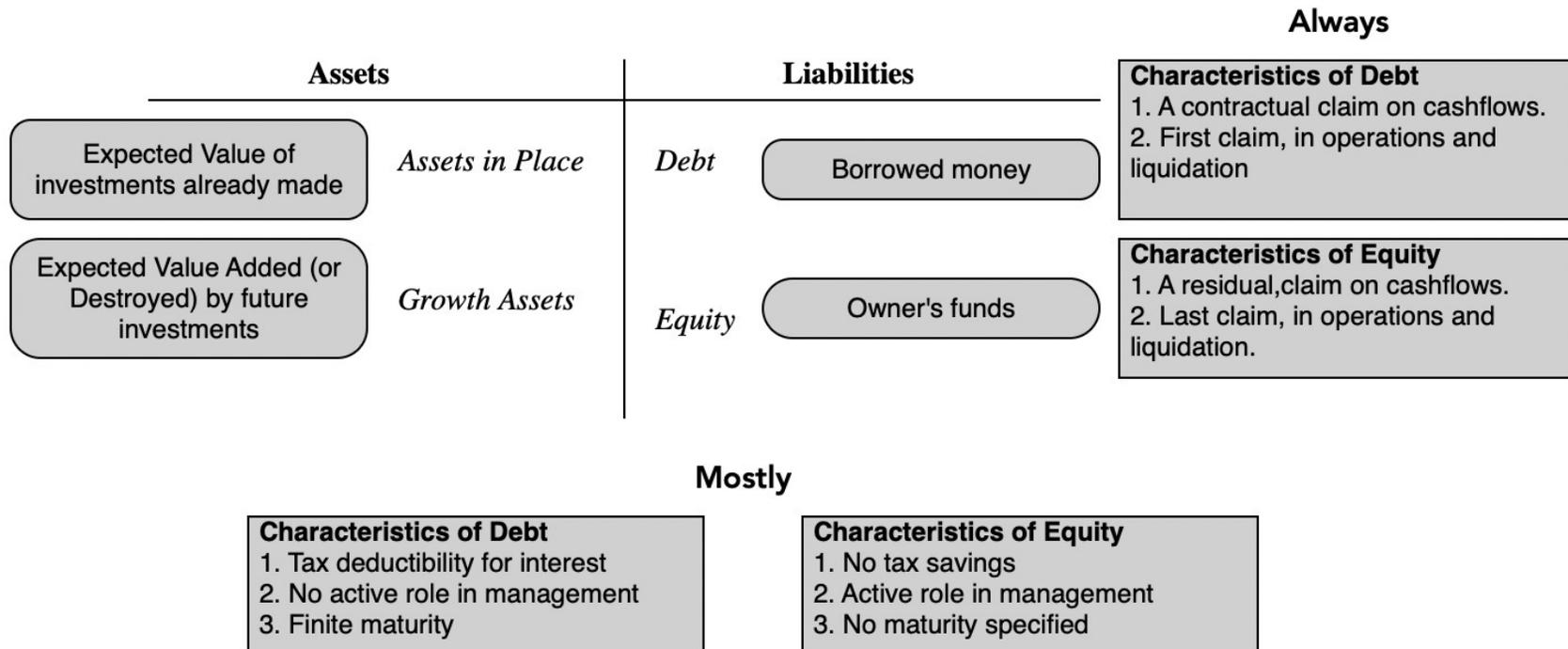
”Neither a borrower nor a lender be”

# DEBT ENTERS THE PICTURE!

- In my last two data updates, I focused **first on hurdle rates**, in my fifth data update and then looked at **profitability/return measures** in my sixth data update. Both can be **affected by how much debt** companies choose to have in their financing structure, and it did enter explicitly into my cost of capital calculations, both through the costs of equity/debt and the mix of the two, and into my accounting return calculations, at least for return on equity.
- In this session, I will start with an **examination of the trade off that all businesses face when it comes to choosing between debt and equity** to finance themselves and then look the debt choices that companies made in 2025 to fund their operations.
- As with every other one of my data updates this year, AI enters this conversation not only of the **huge investments that are being made into AI architecture**, but also because a non-trivial portion of this investment is coming from debt, with **private credit as a lead contributor**.

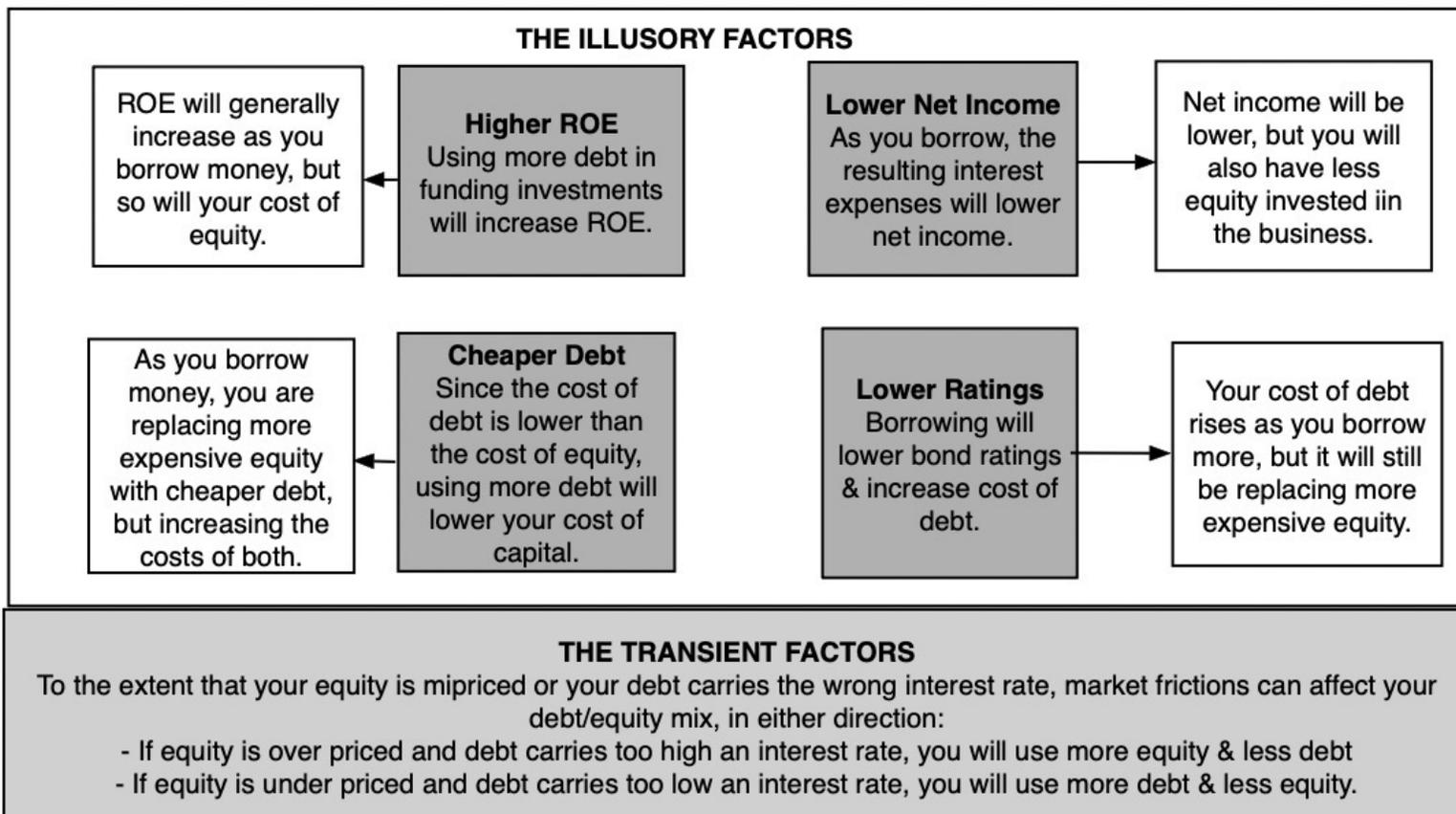
# DEBT VERSUS EQUITY: THE DIFFERENCES!

## *Debt versus Equity*



# DEBT VERSUS EQUITY: THE FICTIONAL TRADEOFFS

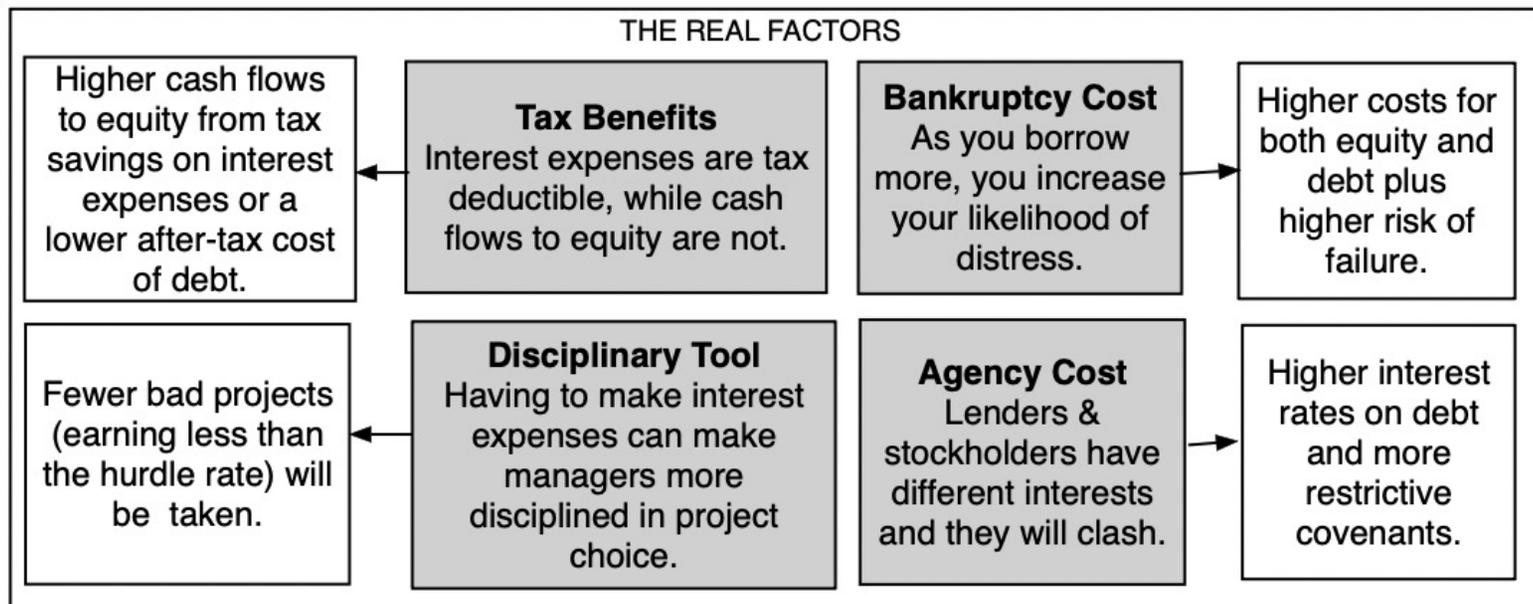
## Debt versus Equity: The Illusory Benefits



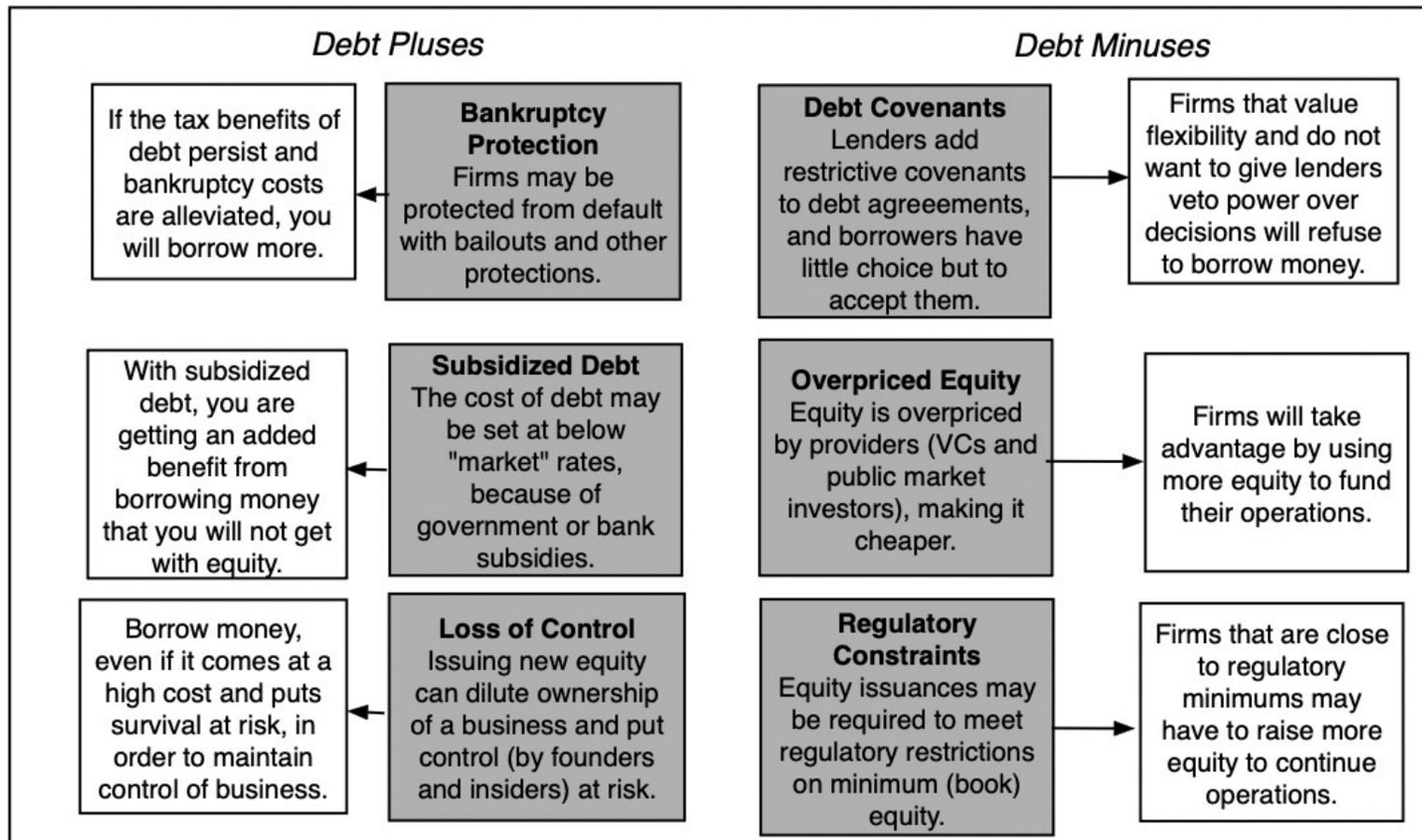
# DEBT VERSUS EQUITY: THE REAL TRADEOFF

*Debt Pluses*

*Debt Minuses*

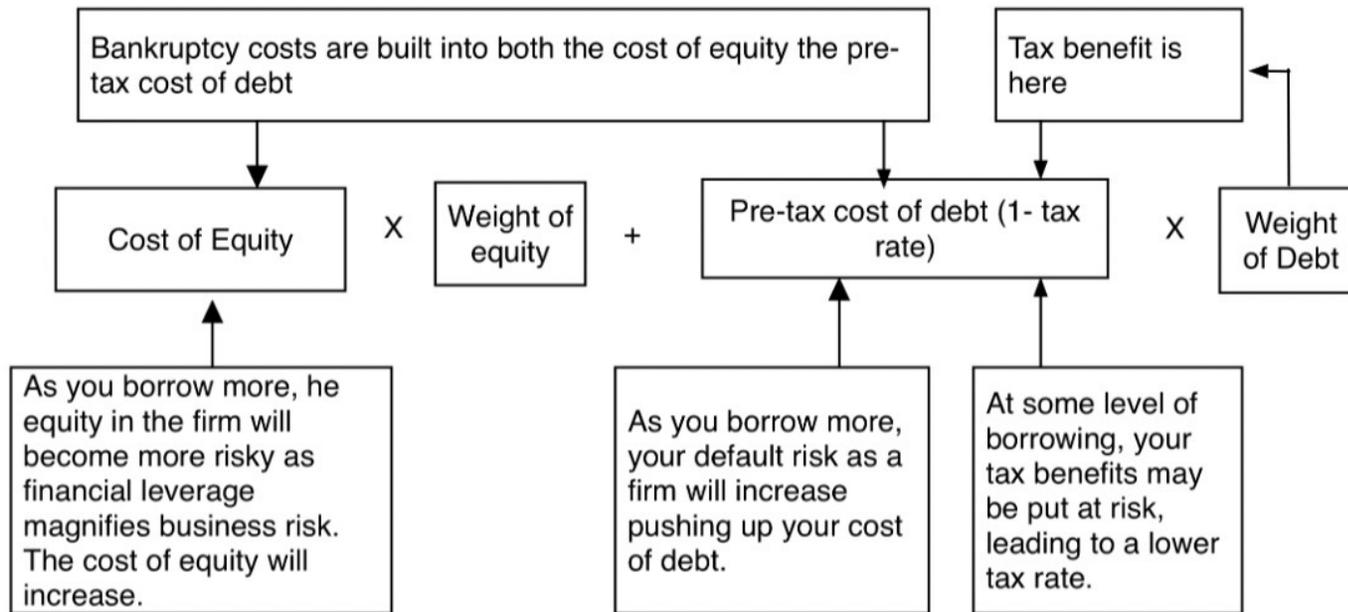


# DEBT VERSUS EQUITY: THE FRICTIONAL TRADEOFF



# A DEBT MIX OPTIMIZER

The optimal mix of debt and equity minimizes your cost of capital, if operating cash flows are unaffected by leverage, and maximizes value, if operating cash flows change with leverage.



*The trade off: As you use more debt, you replace more expensive equity with cheaper debt but you also increase the costs of equity and debt. The net effect will determine whether the cost of capital will increase, decrease or be unchanged as debt ratio changes.*

# DEBT AND TAXES: THE TAX RATE QUESTION

1. Marginal Tax Rates: The marginal tax rate reflects taxes paid on the last dollar of taxable income, and thus comes from the statutory tax code of the domicile that the business operates in. While there are a few companies that try to report these tax rates, you are more likely to uncover them by going into the tax code.
2. Effective tax rates: The effective tax rate is an accounting measure, reflecting the taxes paid and taxable income line items in the income statement, which follows accrual accounting principles.
3. Cash tax rates: The cash tax rates also come from accounting statements, with the information in the statement of cash flows used to convert accrual taxes paid to cash taxes paid, and are reflective of what companies actually pay to governments during the course of the year.



# EFFECTIVE AND CASH TAX RATES IN 2025

Sub Group	# firms	Aggregated Values		Marginal Tax Rate			Effective Tax Rate			Marginal vs Effective	
		Marginal	Effective	1st Quartile	Median	3rd Quartile	1st Quartile	Median	3rd Quartile	>Effective	<Effective
Africa and Middle East	2,555	21.08%	28.73%	20.00%	22.50%	23.00%	8.94%	19.87%	27.99%	56.03%	43.97%
Australia & NZ	1,702	29.87%	29.57%	30.00%	30.00%	30.00%	23.50%	29.28%	31.99%	55.19%	44.81%
Canada	2,576	26.14%	21.97%	26.14%	26.14%	26.14%	18.59%	25.04%	31.13%	56.09%	43.91%
China	7,775	23.41%	17.51%	25.00%	25.00%	25.00%	10.68%	15.52%	23.95%	73.63%	26.37%
EU & Environs	5,649	23.25%	25.11%	20.60%	22.00%	25.83%	17.50%	23.76%	31.38%	43.67%	56.33%
Eastern Europe & Russia	439	15.33%	18.01%	15.00%	16.00%	16.00%	10.29%	15.05%	21.58%	50.00%	50.00%
India	5,170	30.00%	22.33%	30.00%	30.00%	30.00%	21.85%	25.38%	27.79%	82.92%	17.08%
Japan	3,965	29.74%	25.63%	29.74%	29.74%	29.74%	26.53%	30.35%	34.57%	45.68%	54.32%
Latin America & Caribbean	980	26.49%	23.61%	26.53%	30.00%	34.00%	14.69%	24.55%	31.00%	59.49%	40.51%
Small Asia	10,367	23.12%	20.27%	20.00%	22.00%	26.40%	16.56%	21.28%	28.84%	51.83%	48.17%
UK	984	25.00%	27.60%	25.00%	25.00%	25.00%	20.61%	25.58%	29.95%	44.73%	55.27%
United States	5,994	25.00%	19.38%	25.00%	25.00%	25.00%	17.42%	22.08%	25.92%	69.73%	30.27%
Global	48,156	25.03%	21.77%	23.00%	25.00%	29.74%	15.81%	23.37%	29.86%	59.85%	40.15%

**In 2025, the average cash tax rate across companies with taxable income was 25.86% (21.02%) for global (US) firms, about 1% higher than the effective tax rate in both cases.**

# THE DEFAULT & DISTRESS LANDSCAPE: DEFAULTS IN 2025

Corporate Loan Default Rates for US Companies - 1985 - 2025



## WITH CONCERNS UNDER THE SURFACE

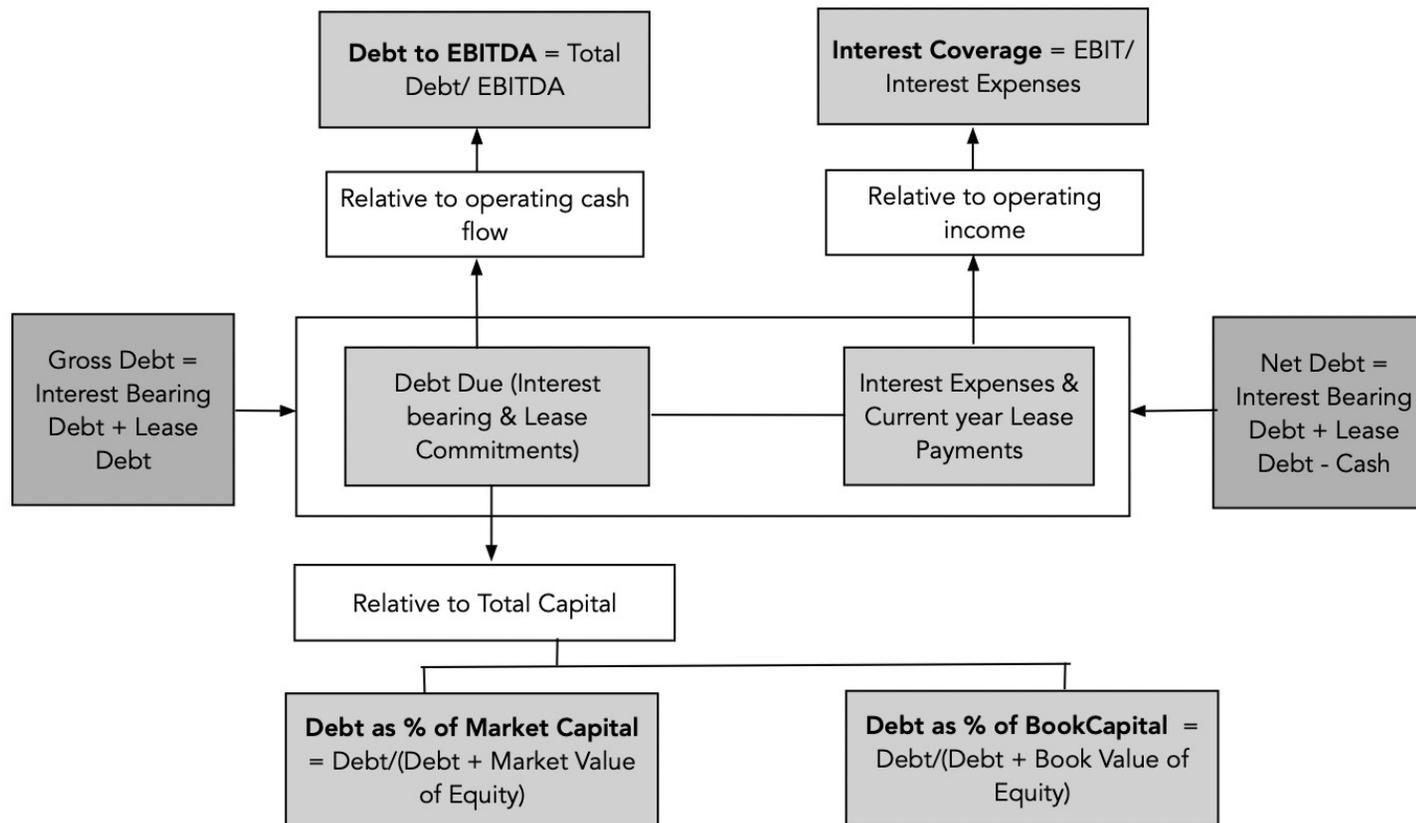
- While the low defaults in 2025 were a positive sign for lenders, especially given the economic turmoil created by tariffs and trade wars, there were **some worrying trends as well**.
- During the year, Moody's estimate of the **probability of default at US companies spiked to 9.2%** in May 2025, a post-2008 high.
- On the bond ratings front, you had **more ratings downgrades than upgrades during 2025**, estimates of the probability of default spiked during the year and **almost \$60 billion in corporate bonds slipped below investment grade** during the year.

# THE BOND RATINGS PICTURE IN 2025

	Africa and Middle East	Australia & NZ	Canada	China	EU & Environs	Eastern Europe & Russia	India	Japan	Latin America & Caribbean	Small Asia	UK	United States	Global
AAA	0	0	0	0	0	0	0	0	0	0	0	2	2
AA+	0	0	0	1	3	0	0	0	0	1	0	2	7
AA	0	0	0	0	10	0	0	0	0	3	0	4	17
A+	6	1	8	10	35	0	0	14	1	3	4	17	99
A	8	3	5	17	24	0	1	22	4	9	8	45	146
A-	11	12	6	19	56	0	3	22	7	21	9	80	246
BBB+	10	10	11	19	80	1	1	9	13	15	19	129	317
BBB	1	14	16	23	69	0	21	11	22	27	20	165	389
<b>Investment Grade</b>	<b>36</b>	<b>40</b>	<b>46</b>	<b>89</b>	<b>277</b>	<b>1</b>	<b>26</b>	<b>78</b>	<b>47</b>	<b>79</b>	<b>60</b>	<b>444</b>	<b>1223</b>
BBB-	7	6	15	19	61	2	2	0	24	13	9	113	271
BB+	3	2	5	2	37	1	3	4	7	7	5	117	193
BB	2	0	4	4	31	2	0	1	22	1	3	112	182
BB-	3	1	14	4	20	1	2	1	10	4	6	91	157
B+	2	1	15	2	7	0	2	0	5	2	3	88	127
B	3	1	9	2	5	0	0	0	3	2	5	59	89
B-	8	0	3	0	7	0	0	2	8	0	3	25	56
CCC+	0	0	0	0	4	0	0	0	0	0	2	23	29
CCC	0	0	1	0	2	1	0	0	0	0	0	4	8
CCC-	0	0	0	0	0	0	0	0	0	0	1	0	1
CC	0	0	1	0	0	0	0	0	0	0	0	0	1
D	0	0	0	0	0	0	0	0	0	0	0	1	1
<b>Below Investment Grade</b>	<b>28</b>	<b>11</b>	<b>67</b>	<b>33</b>	<b>174</b>	<b>7</b>	<b>9</b>	<b>8</b>	<b>79</b>	<b>29</b>	<b>37</b>	<b>633</b>	<b>1115</b>
<b>Not Rated</b>	<b>2,488</b>	<b>1,646</b>	<b>2,461</b>	<b>7,651</b>	<b>5,182</b>	<b>431</b>	<b>5,135</b>	<b>3,879</b>	<b>854</b>	<b>10,253</b>	<b>887</b>	<b>4,906</b>	<b>45,773</b>
<b>% of firms not rated</b>	<b>1.11%</b>	<b>0.66%</b>	<b>2.65%</b>	<b>0.43%</b>	<b>3.25%</b>	<b>1.60%</b>	<b>0.17%</b>	<b>0.21%</b>	<b>8.47%</b>	<b>0.28%</b>	<b>4.00%</b>	<b>11.43%</b>	<b>2.38%</b>
<b>% of rated w/ investment grade</b>	<b>56.25%</b>	<b>78.43%</b>	<b>40.71%</b>	<b>72.95%</b>	<b>61.42%</b>	<b>12.50%</b>	<b>74.29%</b>	<b>90.70%</b>	<b>37.30%</b>	<b>73.15%</b>	<b>61.86%</b>	<b>41.23%</b>	<b>52.31%</b>

# DEBT BURDEN MEASURES

## Measuring the Debt Burden



# DEBT COMFORT METRICS IN 2025: BY SECTOR

Global									
Primary Sector	# firms	Aggregated Values		Interest Coverage Ratio			Debt to EBITDA		
		Int Cov Ratio	Debt/EBITDA	1st Quartile	Median	3rd Quartile	1st Quartile	Median	3rd Quartile
Communication Services	2,193	5.52	2.49	2.75	7.60	41.89	0.21	1.51	4.25
Consumer Discretionary	6,358	5.98	3.49	2.30	6.25	21.71	0.66	2.47	5.34
Consumer Staples	3,202	6.44	2.77	2.96	7.76	29.40	0.38	1.86	4.38
Energy	1,402	8.00	1.69	2.18	4.70	11.72	0.45	1.60	4.00
Financials	5,278	NA	NA	NA	NA	NA	NA	NA	NA
Health Care	4,452	6.12	2.77	3.25	9.53	42.77	0.21	1.56	3.98
Industrials	9,007	3.38	4.03	2.84	8.02	30.28	0.45	1.96	4.77
Information Technology	6,234	13.89	1.61	4.66	15.30	68.44	0.24	1.33	3.95
Materials	6,457	4.87	3.05	2.46	6.59	21.90	0.10	1.70	4.52
Real Estate	2,671	1.85	10.61	1.56	2.95	7.50	1.44	6.04	11.76
Utilities	902	3.06	5.10	1.92	3.34	7.86	1.39	3.94	6.44
Global	48,156	5.31	6.97	2.59	7.26	28.45	0.37	2.01	5.32

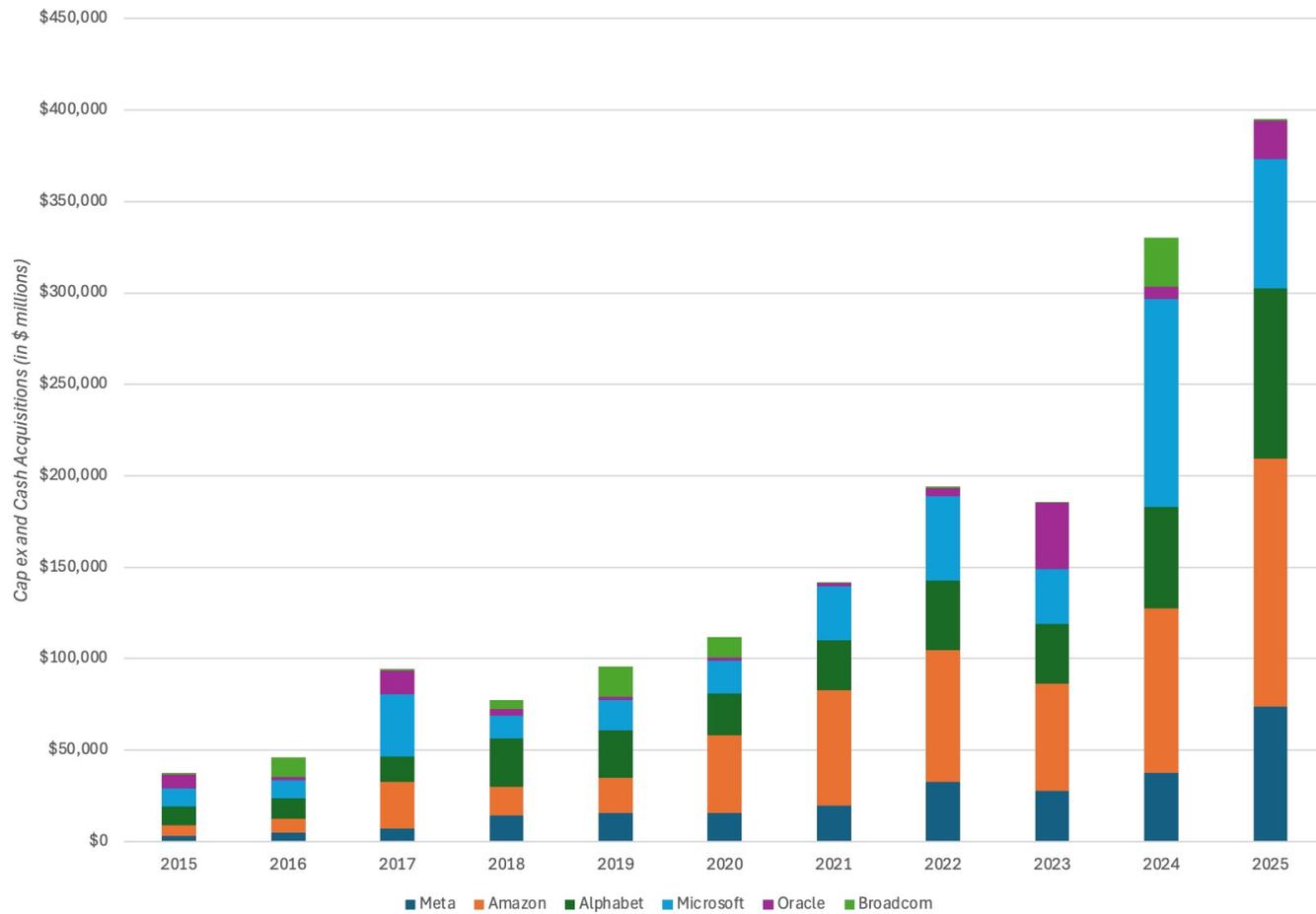
US									
Primary Sector	# firms	Aggregated Values		Interest Coverage Ratio			Debt to EBITDA		
		Int Cov Ratio	Debt/EBITDA	1st Quartile	Median	3rd Quartile	1st Quartile	Median	3rd Quartile
Communication Services	315	7.54	2.07	0.89	2.59	6.03	0.78	3.30	5.76
Consumer Discretionary	581	6.38	3.07	1.84	4.64	13.86	1.67	3.20	5.71
Consumer Staples	297	8.13	2.49	3.29	6.93	16.80	1.44	2.48	4.11
Energy	282	6.46	1.84	2.30	4.11	8.41	0.89	1.71	3.24
Financials	1,224	NA	NA	NA	NA	NA	NA	NA	NA
Health Care	1,178	5.73	2.93	1.79	5.20	11.64	0.50	2.48	4.32
Industrials	796	5.12	3.19	2.73	6.58	12.88	1.05	2.29	3.72
Information Technology	706	18.38	1.36	2.95	7.33	19.55	0.56	2.08	4.32
Materials	273	5.43	2.68	2.37	4.52	12.05	1.24	2.92	4.51
Real Estate	253	1.99	6.03	0.81	1.69	2.84	4.87	6.35	9.55
Utilities	89	2.38	5.61	2.21	2.62	3.07	4.32	5.40	6.01
Global	6,006	6.86	5.87	2.01	4.55	11.86	1.35	3.46	8.39

# DEBT LEVEL METRICS IN 2025

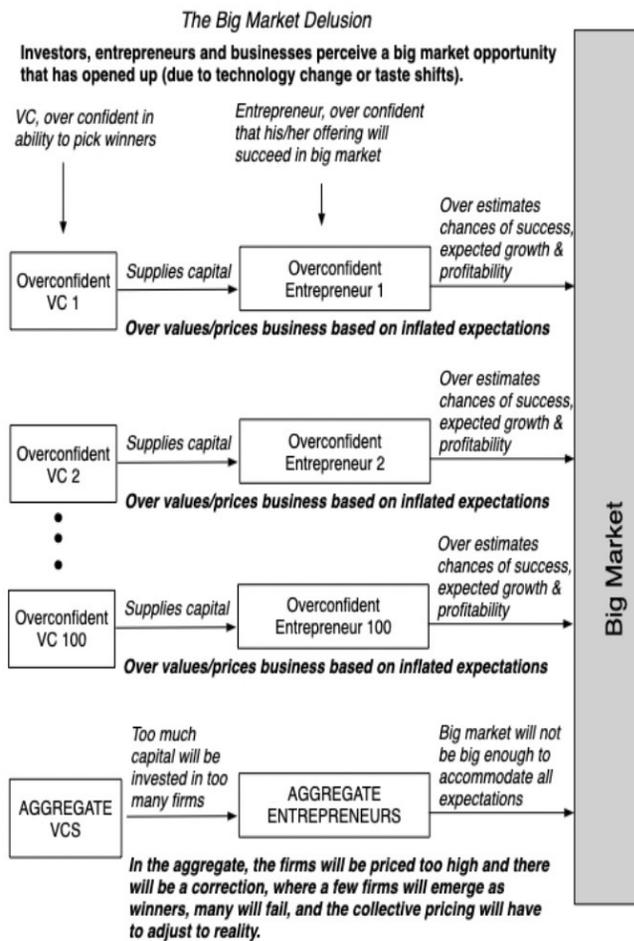
Global											
Primary Sector	# firms	Aggregated Values		Aggregated Values		Gross Debt to Capital (Book)			Gross Debt to Capital (Market)		
		Gross Debt/Capital (Book)	Gross Debt/Capital (Market)	Net Debt/Capital (Book)	Net Debt/Capital (Market)	1st Quartile	Median	3rd Quartile	1st Quartile	Median	3rd Quartile
Communication Services	2,193	44.23%	19.02%	38.94%	15.11%	2.72%	16.95%	43.94%	0.79%	9.85%	34.04%
Consumer Discretionary	6,358	46.90%	22.21%	37.45%	15.72%	8.04%	27.77%	49.08%	3.36%	17.66%	44.44%
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Energy	1,402	33.21%	23.26%	26.20%	14.21%	2.92%	22.18%	44.89%	0.48%	14.28%	39.40%
Financials	5,278	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
Health Care	4,452	40.78%	14.98%	32.23%	10.13%	2.52%	15.54%	37.92%	0.50%	6.39%	22.16%
Industrials	9,007	45.90%	25.59%	36.72%	18.14%	6.19%	24.16%	45.50%	2.47%	13.84%	36.18%
Information Technology	6,234	31.94%	6.27%	17.18%	2.68%	3.22%	15.37%	35.85%	0.76%	6.27%	21.35%
Materials	6,457	37.07%	23.35%	29.42%	15.09%	0.74%	15.42%	38.93%	0.14%	7.63%	30.13%
Real Estate	2,671	47.83%	46.54%	44.17%	41.05%	9.56%	34.01%	51.61%	5.75%	34.42%	57.01%
Utilities	902	56.03%	45.22%	53.49%	47.53%	16.13%	42.41%	59.21%	9.67%	36.81%	55.93%
Global	48,156	56.03%	33.98%	47.66%	29.26%	3.97%	21.78%	44.88%	1.16%	12.09%	36.74%
US											
Primary Sector	# firms	Aggregated Values		Aggregated Values		Gross Debt to Capital (Book)			Gross Debt to Capital (Market)		
		Gross Debt/Capital (Book)	Gross Debt/Capital (Market)	Net Debt/Capital (Book)	Net Debt/Capital (Market)	1st Quartile	Median	3rd Quartile	1st Quartile	Median	3rd Quartile
Communication Services	315	46.01%	13.15%	42.44%	11.32%	7.15%	36.65%	58.20%	0.00%	11.17%	47.20%
Consumer Discretionary	581	59.84%	17.05%	54.40%	15.00%	20.77%	46.15%	65.25%	2.53%	22.96%	53.81%
Consumer Staples	297	53.07%	16.68%	48.70%	14.68%	14.76%	39.00%	57.06%	0.00%	10.40%	35.43%
Energy	282	34.53%	23.23%	31.52%	17.20%	10.02%	27.55%	43.75%	0.00%	12.37%	35.48%
Financials	1,224	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
Health Care	1,178	47.86%	15.38%	40.41%	11.67%	2.67%	15.64%	43.68%	0.31%	6.32%	24.55%
Industrials	796	54.44%	17.98%	49.30%	15.61%	14.97%	35.82%	54.48%	1.19%	11.50%	29.60%
Information Technology	706	37.03%	4.77%	27.53%	3.03%	4.70%	17.79%	42.40%	0.37%	4.74%	18.80%
Materials	273	41.42%	21.19%	36.06%	16.18%	10.44%	35.58%	51.57%	0.00%	9.63%	33.90%
Real Estate	253	52.54%	33.40%	50.84%	33.00%	36.11%	48.80%	61.73%	24.22%	39.45%	62.66%
Utilities	89	61.65%	43.23%	61.01%	50.99%	48.91%	58.85%	64.09%	24.75%	42.36%	51.70%
Global	6,006	61.83%	26.02%	57.26%	25.16%	8.55%	30.93%	53.46%	0.33%	11.46%	35.95%

# AI — THE INVESTMENT SIDE

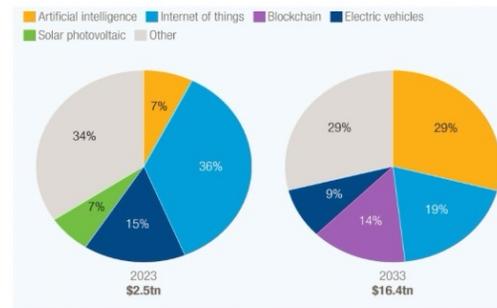
*The Ramping up of Tech Cap Ex*



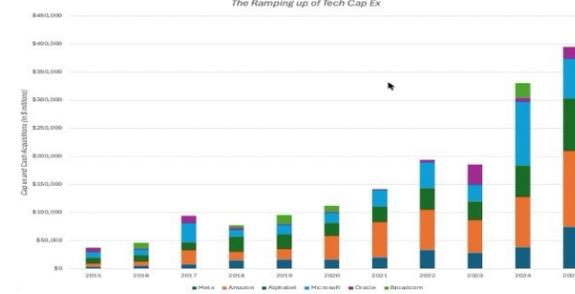
# THE BIG MARKET DELUSION IN AI?



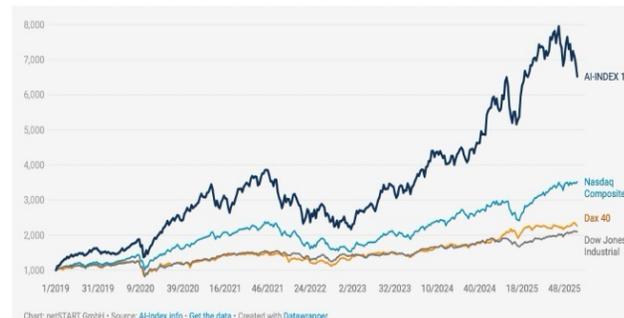
The Promise of AI: A "Huge" Winner(s)-take-all Market



Draws big investments in AI

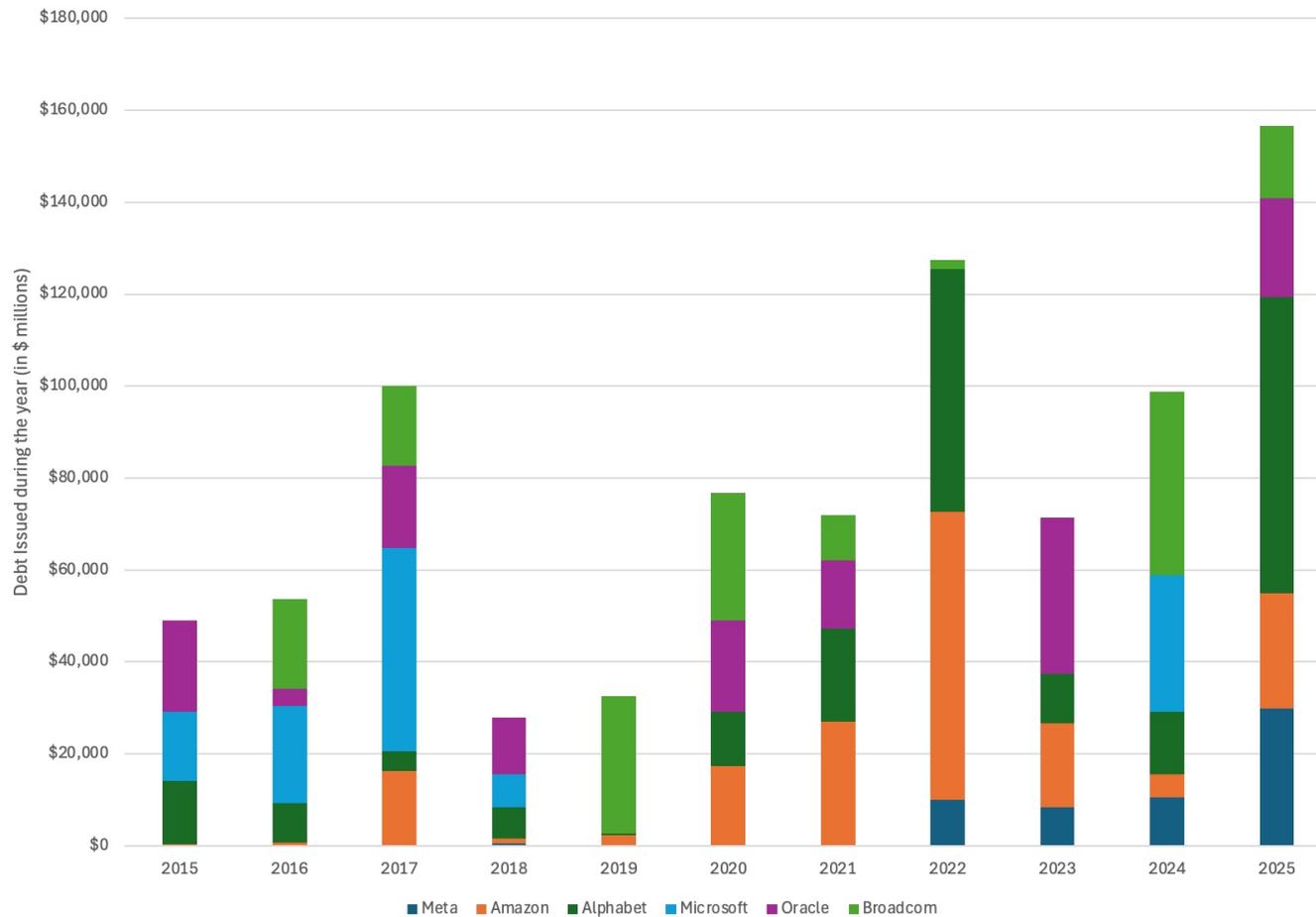


And Markets have gone along (for the moment)



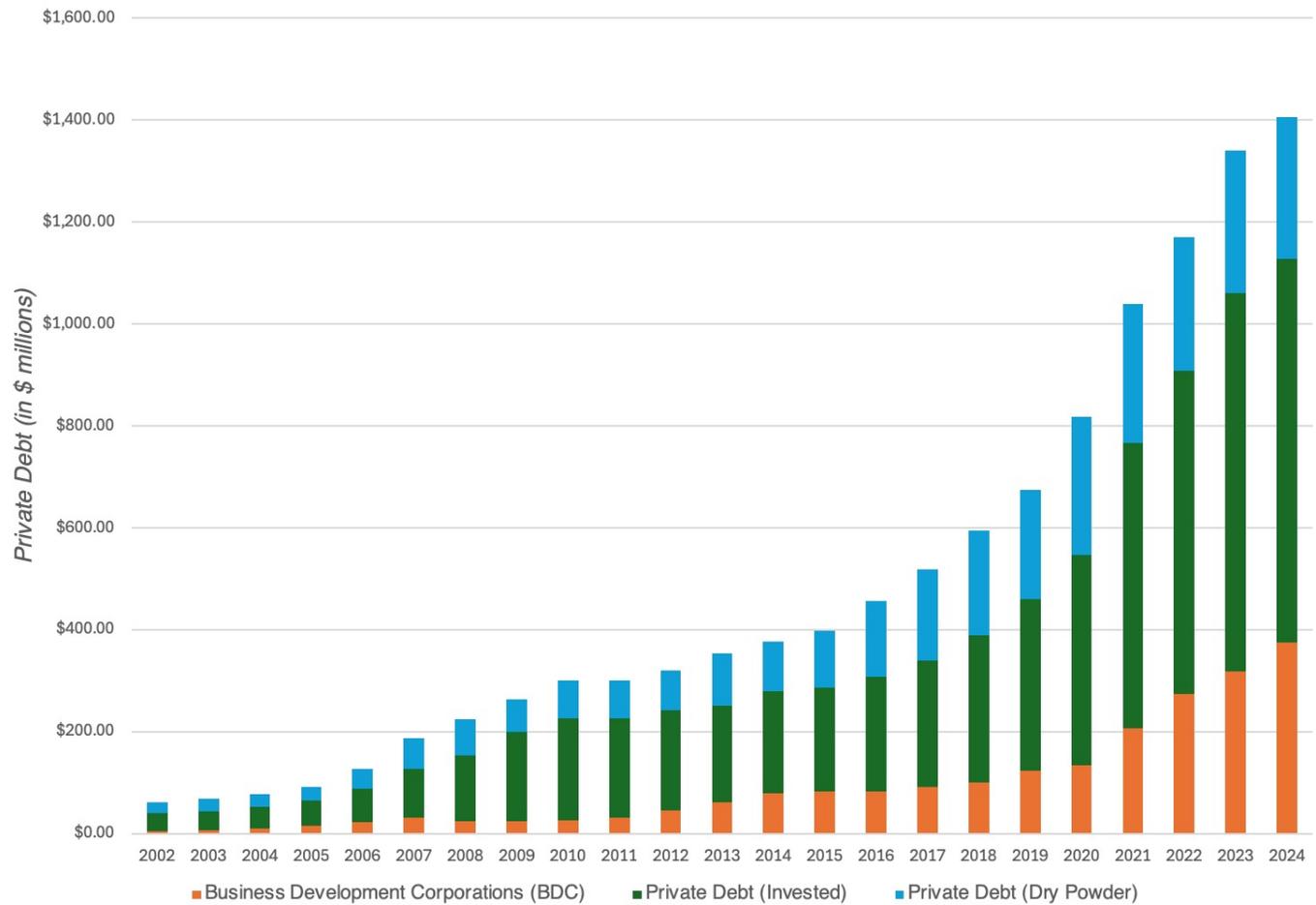
# AI — THE FINANCING SIDE

Debt Issuances at Big Tech



# PRIVATE CREDIT - A RISING FORCE!

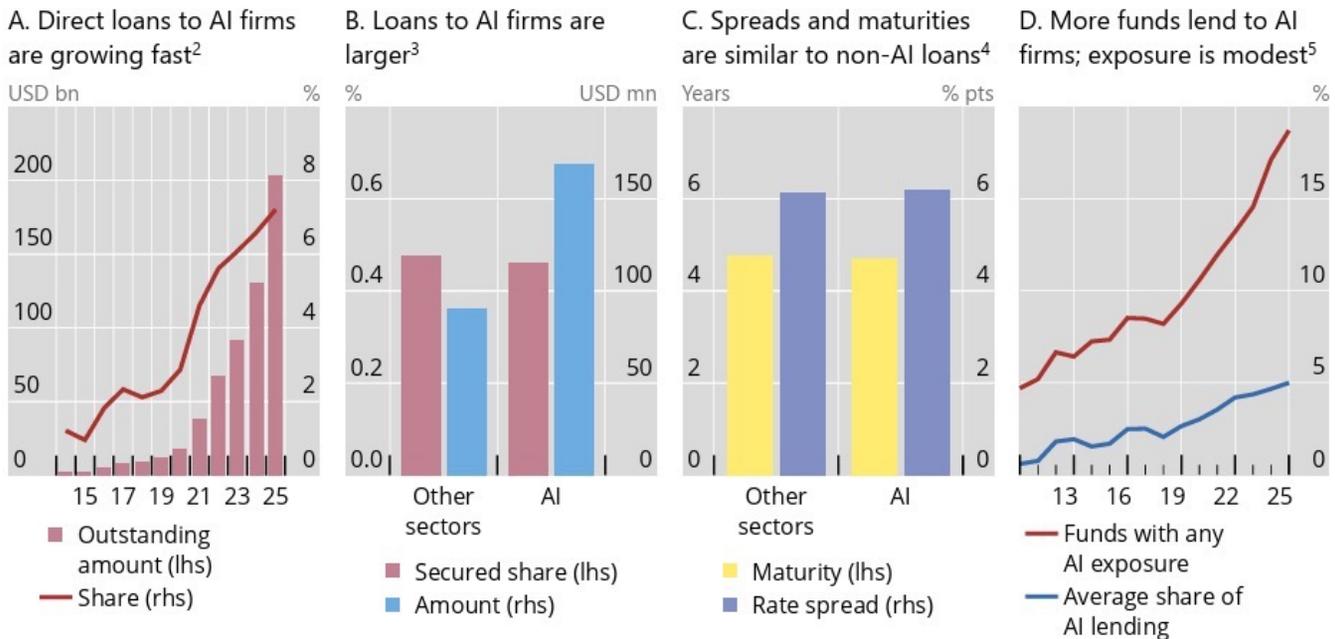
*The Rise of Private Credit*



# WITH A LARGE AI FOOTPRINT..

Private credit is a key source of funding for AI firms<sup>1</sup>

Graph 3



<sup>1</sup> "AI firms" refers to firms operating in the Pitchbook-defined verticals "Artificial Intelligence", "Big Data" and "Cloud Tech". <sup>2</sup> Outstanding direct loan amounts to AI firms in billions of US dollars as well as share of total outstanding direct loans. <sup>3</sup> "Amount" is the size of the average loan. "Secured share" denotes the proportion of loans secured by collateral. <sup>4</sup> "Rate spread" is the annual rate over the London Interbank Offered Rate or the Secured Overnight Financing Rate. <sup>5</sup> Share of all private credit funds with loans originated to at least one AI-related company in a quarter (red line) as well as share of total outstanding loan volumes to AI-related firms over total outstanding loan volumes for the average fund (blue line).

# A STORM COMING?

- If you agree with my contention that companies are collectively over investing in AI, driven by **the big market delusion**, there will be a time when **that delusion will dissipate, and markets will have to correct.**
  - In an **all or mostly-equity driven space**, the pain will be borne **by shareholders** or owners of these companies, but while painful to them, its ripple effects will be limited.
  - When debt enters the picture, as it has with some of the AI investment, **the effects of a correction will no longer be isolated to equity investors in these companies, and as private credit gets repriced (from the marking of debt down to reflect higher default risk), the pain to the rest of the economy increases.**
- Private credit has had a good run, in terms of delivering returns to investors in it, but **a shakeout is overdue**, which will separate the sloppy lenders from the good ones, and **perhaps shrink private credit to healthier levels.**